The Public Financial System in Japan – Re-verification of the ballooning theory and the privileged government enterprise theory –

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Abstract

The large weight of public financial institutions is often identified as one of the characteristics of the Japanese financial system. It is believed that reform of the private financial sector is not enough to revitalize the Japanese financial system, but reform of the public financial sector is crucial. There are various opinions concerning ideal public financial institutions, and heated debate continues. We would like to raise attention to the point that much discourse is based on the prerequisite that public financial sector is still increasing (i.e., the ballooning theory). However, only a small number of arguments present grounds for the prerequisite, and even in the case of those based on statistical analyses, such analyses are not rigorously verified. Under these circumstances, the first purpose of this paper is to reverify the ballooning theory of public financial sector which is used as a prerequisite for much of the discourse.

Of course, although the ballooning theory may be overstated, private financial institutions’ cries for help strongly suggest that they are being squeezed by public institutions. The reason why public financial institutions that should be tightly regulated have such great power and oppress the private sector, which has been significantly deregulated in recent years, is often thought to be because so many privileges are given to public financial institutions as government enterprises (the privileged government enterprise theory). We agree that government enterprises have privileges, but if these are small, it is difficult to say that they are the main cause of the competitive dominance of government enterprises. The size of the privileges must be quantified to assess the privileged government enterprise theory. This is the second purpose of this paper.

The following are the major conclusions of this paper. Concerning the public financial sector ballooning theory, various indexes prove that public financial activities had increased in share by around 1998, so from this aspect the ballooning theory is correct. However, this situation changed and since 1998 public financial
activities have either remained at the same level or have tended to decline. Further attention should be paid to the fact that when examining the relative size of public financial activities, the result varies significantly depending on how the area of interest is set. For instance, if finance is viewed as a risk bearing mechanism rather than a flow of funds, public involvement in finance in the U.S. may be greater than in Japan.

Concerning the privileged government enterprise theory, it is true that Japan Post has privileges (e.g., the exemption of taxes as current expenses), but the estimate of ¥4.6 trillion over ten years by the Japanese Bankers Association is considered to be excessive. It may be judged that most of the privileges of the government enterprise have been eliminated during the establishment process of Japan Post and the conditions of government enterprise for competition are almost equalized with the private sector. On the other hand, government enterprise may become unable to bear the burden caused by restrictions imposed on them any longer (particularly the obligation of maintaining offices in remote areas), so how Japan Post can bear the burden must be considered.

This paper is organized as follows. Section II examines the ballooning of the public financial sector, which is treated as the starting point of the debate concerning the reform of public financial system in Japan. Section III re verifies the privileges enjoyed by government enterprises. Section IV presents the conclusions of this paper.

I. Introduction

The significant influence of the public financial system is frequently pointed out as a characteristic of the Japanese financial system. The prevailing opinion is that, in order to revive the financial system, reform of the public financial sector as well as the private financial sector is essential. In other words, reconsidering the role of the government as a financial intermediation service provider has become increasingly necessary. In fact, reform of public financial system has been discussed since the 1980s, and its likelihood has gradually increased during the long-term economic stagnation and growing financial uneasiness after the collapse of the financial bubble.

The most significant movement regarding the public financial system since the 1990s is the crucial reform in the government’s investment and loan program enacted in April 2001. As a result, 1) full abolition of the deposit requirement system for postal savings/pension reserves and discretionary management; 2) adoption of market principles for government investment and loan institutions’ fund procurement (issuance of investment-and-loan institutions bonds); and 3) introduction of the policy cost analysis, were implemented. In addition, it should be noted that responsibility for the postal service was transferred from the Ministry of Posts and Telecommunications to the Postal Services Agency, and then again to the Japan Post in April 2003.

As just described, it is true that the public financial system which has continued for more than 50 years after the Second World War faced a drastic change, and whether the public financial
sector ought to continue is still actively debated. In other words, there is a considerable difference in opinion regarding further reforms, including the opinion that the postal service privatization, and abolition and integration of government-affiliated financial corporations, should proceed, that the present status quo should be maintained, and that the types of services and the lines of business should be diversified without changing the corporate structure. In this regard, it should be recognized that the current ballooning of the public financial system is often used as a legitimate premise for discussion. However, it is surprising that an appropriate basis for such an argument is rarely shown. Even when some statistics are given, it appears that the validity of such statistics is not sufficiently examined. Therefore, the first objective of this article is to re-examine the public financial sector ballooning theory.

Of course, even if reality is somewhat exaggerated in the ballooning theory, from the outcry of private-sector financial institutions, there is no doubt that private corporations are under pressure. Generally speaking, government enterprises are inefficient. For example, of the three branches of Japan Post’s services, the postal service had an uphill battle against private trucking service providers. However, in the financial services, the public financial sector matched or got the better of private operators, and as a result, the private-sector financial institutions continue to voice their complaints that “private sector corporations are under pressure”. The regulatory framework for the public financial sector hasn’t changed much, but the scope of services provided by the private-sector financial institutions has expanded considerably, and they are now in a position to adopt a new corporate structure such as a financial holding company. Therefore, the competitive advantage of the private-sector financial institutions must have increased in recent years. Nevertheless, the public financial sector (which should be under rigid control) still has the dominant power, and squeezes the private-sector corporations.

In the eyes of private-sector financial institutions, the reason is simple: because enormous “privileges for government enterprises” are given to the public financial sector (the privileged government enterprise theory). Thus, privatization to equalize competitive conditions for both the private and public sectors or, even without privatization, a reduction or abolition of government enterprise privileges has been sought. However, we would like to examine whether the privileges for government enterprises give the public financial sector the competitive advantage. The authors do not deny that there are privileges for government enterprises, but if such privileges are small in terms of the amount, it is difficult to believe that such privileges bring meaningful competitive advantage. Therefore, in order to evaluate the privileged government enterprise theory, we first need to know the size of the privileges for government enterprises. The second purpose of this article is to verify the validity of the estimate provided by the Japanese Bankers Association shown in Section III, which is often quoted.

This paper is divided as follows: Section II examines public financial sector ballooning, which is regarded as the premise for discussion on the public financial system reform in Japan. Section III investigates “privileges for government enterprises”. Section IV is the conclusion.
II. Does the Public Financial Sector Carry a Significant Weight?

The reformers that insist on the need for public financial system reforms may feel that the resource allocation function of Japanese financial markets is distorted as a result of public financial sector ballooning. For this discussion to have validity, it is necessary to show that public financial sector has actually ballooned and then accurately measure the size of the distortion of the resource allocation that the public financial sector causes. This paper examines the public financial sector ballooning theory, as mentioned in the Introduction, because the theory does not seem to be properly evaluated although it is used as a legitimate premise for the public financial system reform discussion.

II.1. Change in the Size/Weight of the Public Financial Sector in Japan

First, the transition in the scale of Japanese public financial sector will be considered. (C) in Table 1 shows the ratio of the outstanding assets in the private non-financial sector held by public financial institutions (B) to the outstanding liabilities of the private non-financial sector (A). Here, the public financial sector includes government-affiliated financial institutions which directly compete against private corporations, and postal savings’ depositor loans. According to Table 1, there is an obvious overall increase in the share of financial activities by the public financial sector in Japan since the beginning of the 1990s. This was directly caused by the fact that the stabilization function allegedly inherent to government investments and loans were actively used during the depression that followed the collapse of the economic bubble. However, no significant changes have been seen during the last 5 years (from 1998 to 2002), rather there has been a decrease in this amount.

The middle column of Table 1 considers the amount of shareholdings and capital investments. Since assets of public institutions are limited to the balance of money loans (including bond holding), the weight of public financial system (C’) is relatively greater when we exclude the amount of shareholdings and capital investments. While various investments and loans are available to private-sector financial institutions including banks, since business lines are restricted to financing loans and limited investments, the government-affiliated financial institutions have greater weight in the loan business. Therefore, when we focus only on the loan business, the “pressure” is emphasized. In addition, the weight naturally increases when Government special account loans to the public non-financial sector (government corporations and public business organizations, such as Japan Highway Public Corporation) are included. This is shown as (C”) in Table 1.1)

1) For reference, the above figures do not include outstanding debt guarantees by credit guarantee associations or other government agencies. According to the survey by the Ministry of Internal Affairs and Communications (2003), the guaranteed amount as of the end FY2001 is JPY 37,757.3 billion (mostly by the Credit Guarantee Associations). By adding this amount to (B’), the share of public financial sector as of the end-FY2001 increases from 18.1% as shown in (C’’) to 21.0%.
Table 1  Change in the Size/Share of the Public Financial Sector in Japan

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<tbody>
<tr>
<td>Outstanding liabilities of the private non-financial sector: (A)</td>
<td>1630.4</td>
<td>1702.5</td>
<td>1518.2</td>
<td>1726.1</td>
<td>1588.8</td>
<td>1586.0</td>
<td>1459.1</td>
</tr>
<tr>
<td>Outstanding assets in the private non-financial sector held by the public financial sector (postal savings + government-affiliated financial institutions): (B)</td>
<td>113.2</td>
<td>167.6</td>
<td>194.4</td>
<td>196.4</td>
<td>195.7</td>
<td>190.0</td>
<td>181.3</td>
</tr>
<tr>
<td>(B) / (A) × 100: (C)</td>
<td>6.9</td>
<td>9.8</td>
<td>12.8</td>
<td>11.4</td>
<td>12.3</td>
<td>12.0</td>
<td>12.4</td>
</tr>
<tr>
<td>(A) less outstanding shares / investments: (A')</td>
<td>1199.3</td>
<td>1296.8</td>
<td>1221.1</td>
<td>1192.8</td>
<td>1169.6</td>
<td>1217.7</td>
<td>1085.1</td>
</tr>
<tr>
<td>(B) less outstanding shares / investments: (B')</td>
<td>111.9</td>
<td>163.2</td>
<td>188.5</td>
<td>190.7</td>
<td>189.9</td>
<td>185.2</td>
<td>177.0</td>
</tr>
<tr>
<td>(B') / (A') × 100: (C')</td>
<td>9.3</td>
<td>12.6</td>
<td>15.4</td>
<td>16.0</td>
<td>16.2</td>
<td>15.2</td>
<td>16.3</td>
</tr>
<tr>
<td>(A') plus outstanding borrowings by the public non-financial sector: (A')'</td>
<td>1256.3</td>
<td>1358.8</td>
<td>1276.4</td>
<td>1251.0</td>
<td>1236.8</td>
<td>1286.9</td>
<td>1156.2</td>
</tr>
<tr>
<td>(B') plus outstanding special account loans to the public non-financial sector: (B')'</td>
<td>148.0</td>
<td>202.0</td>
<td>225.4</td>
<td>230.7</td>
<td>233.6</td>
<td>232.3</td>
<td>227.1</td>
</tr>
<tr>
<td>(B')' / (A')' × 100: (C')'</td>
<td>11.8</td>
<td>14.9</td>
<td>17.7</td>
<td>18.4</td>
<td>18.9</td>
<td>18.1</td>
<td>19.6</td>
</tr>
</tbody>
</table>

Note: The outstanding balance is in JPY in trillions; ratios are in %. Figures are provided by the “FY2002 National Economic Accounting”, Cabinet Office.

II. 2.  The Share of the Postal Savings

Next, the size and the share of the Postal Savings as a funding body for public financial system will be considered.

Table 2 follows the changes in the share of postal savings since 1990 in 2-year cycles. It can be seen that Japanese households strengthened the tendency toward risk-free assets, including bank deposits and postal savings, after the collapse of the economic bubble (A). The ratio of postal savings (B) to “deposits and savings” showed limited growth during the high-interest period during the collapse of the bubble economy, gradually increasing until 1998 and then rapidly falling.

This data suggests that the postal savings increased its share of the Japanese households' financial assets primarily due to a reflection of the growing tendency of the Japanese public toward safer assets. The percentage of safe assets held by Japanese households (excluding NPOs for statistical reasons) is shown in Table 3. Here, “government-related assets” are government bonds, investment and loan bonds, municipal bonds, bonds issued by government-affiliated agencies and postal savings. “Risk-free assets” are government-related assets plus cash and bank deposits except for foreign currency deposits.

2) Life insurance policies are excluded.
The ratio of government-related assets to risk-free assets, as shown in (C) at the bottom of Table 3, should be noted. It is true that the ratio of government-related assets, including postal savings, to total assets is higher in Japan than in the United States. However, in terms of risk-free assets, government-related assets do not hold larger shares in Japan than they have in the United States. The fact that postal savings absorb a huge percentage of household financial assets in Japan is reflected only by the heavy weight of safe assets (i.e., deposits and savings) in Japanese households’ portfolios.

### Table 2  Change in the share of Postal Savings in the Household Sector

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<tbody>
<tr>
<td>Financial assets (JPY in trillions)</td>
<td>1034.8</td>
<td>1098.4</td>
<td>1195.7</td>
<td>1290</td>
<td>1343.7</td>
<td>1423.5</td>
<td>1368.7</td>
</tr>
<tr>
<td>Deposits &amp; savings (JPY in trillions)</td>
<td>463.7</td>
<td>521.9</td>
<td>580</td>
<td>633.9</td>
<td>693.6</td>
<td>717.8</td>
<td>734.9</td>
</tr>
<tr>
<td>The ratio of deposits and savings to household financial assets (%) (A)</td>
<td>44.8</td>
<td>47.8</td>
<td>48.5</td>
<td>49.1</td>
<td>51.6</td>
<td>50.4</td>
<td>53.7</td>
</tr>
<tr>
<td>Postal savings (JPY in trillions)</td>
<td>135.3</td>
<td>169.5</td>
<td>196.9</td>
<td>224.3</td>
<td>251.8</td>
<td>248.9</td>
<td>231.3</td>
</tr>
<tr>
<td>The ratio of postal savings to household financial assets (%) (B)</td>
<td>13.1</td>
<td>15.4</td>
<td>16.5</td>
<td>17.4</td>
<td>18.7</td>
<td>17.5</td>
<td>16.9</td>
</tr>
<tr>
<td>The ratio of postal savings to deposits &amp; savings (%) (C)</td>
<td>29.2</td>
<td>32.5</td>
<td>33.9</td>
<td>35.4</td>
<td>36.3</td>
<td>34.7</td>
<td>31.5</td>
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</table>

Note: Source: Material provided by the Central Council for Financial Services Information

### Table 3  Condition of Personal Financial Assets in Japan

<table>
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<tbody>
<tr>
<td>Financial assets</td>
<td>1034.8</td>
<td>1272.7</td>
<td>1343.7</td>
<td>1425.2</td>
<td>1423.5</td>
<td>1402.1</td>
<td>1368.7</td>
</tr>
<tr>
<td>Risk-free assets</td>
<td>489.6</td>
<td>637.6</td>
<td>730.9</td>
<td>750.1</td>
<td>759.7</td>
<td>775.5</td>
<td>772.8</td>
</tr>
<tr>
<td>The ratio of risk-free assets (excluding insurance policies) to financial assets: (A)</td>
<td>47.3</td>
<td>50.1</td>
<td>54.4</td>
<td>52.6</td>
<td>53.4</td>
<td>55.3</td>
<td>56.5</td>
</tr>
<tr>
<td>Government-related assets</td>
<td>144.5</td>
<td>221.9</td>
<td>260.8</td>
<td>267.5</td>
<td>260.9</td>
<td>252.1</td>
<td>246.2</td>
</tr>
<tr>
<td>The ratio of government-related assets to household financial assets: (B)</td>
<td>14.0</td>
<td>17.4</td>
<td>19.4</td>
<td>18.8</td>
<td>18.3</td>
<td>18.0</td>
<td>18.0</td>
</tr>
<tr>
<td>The ratio of government-related assets to risk-free assets: (C)</td>
<td>29.5</td>
<td>34.8</td>
<td>35.7</td>
<td>35.7</td>
<td>34.3</td>
<td>32.5</td>
<td>31.9</td>
</tr>
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</table>

Note 1: figures are provided by the “Fund Flow Account”, Bank of Japan. Outstanding balances are in JPY in trillions; ratios are in %.
Note 2: government-related assets represent governmental bonds, investment-and-loan bonds, municipal bonds, bonds issued by government-affiliated agencies and postal savings, excluding postal life insurance policies.
Note 3: “risk-free assets” represent the above assets plus cash and deposits except for foreign currency deposits, excluding life insurance policies.
II. 3. Summary

The greater weight gained by the public financial sector in Japan in the mid 1990’s in terms of asset management and funding could be verified. However, in order to conclude that the public financial system has more weight in Japan than in other countries, we need further detailed examination. For instance, if “financial activity” is viewed as a risk sharing, rather than a flow of funds, issuance of government–guaranteed securities should also be considered as government financial activities. If so, in the United States where the role of the public financial system is allegedly smaller than in Japan, the weight of public financial sector would be greater than in Japan due to the important roles played by Government Sponsored Enterprises (GSEs) and Federally Related Mortgage Pools (FRMPs).

Therefore, while it is true that the weight of direct financing by the public financial sector is more significant in Japan than in other countries, this cannot serve as a basis of argument that the public sector's financial activities should be reduced. If the United States is a model to be followed, it should be concluded that a re-evaluation of the method of public financial activity (from direct financing to credit enhancement) should be taken. Furthermore, the ballooning theory does not always support management structure reform (such as privatization). For instance, in the United Kingdom and Germany, the scope of business is expanded considerably after the incorporation of the postal service. It should also be noted that, in the United States and European countries, the public financial system reform was promoted in order to improve the effectiveness of public fund management, not to reduce the amount or the scope of its business in order to relieve pressure on private companies.

III. Do Government Enterprises Have Significant Privileges?

III. 1. Estimate of the Privileges for Government Enterprises

The Japanese Bankers Association (2002) estimated that the "privileges for government enterprises" of the postal savings business at JPY612.5 billion (FY2001). Specifically, the breakdown of the estimation is as follows: "taxes as ordinary expenses" (enterprise taxes, fixed

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1) In addition, please note that this article uses figures from the balance sheet to examine the public financial sector's share (like precedent studies). In order to avoid equity capital requirement, derivatives and other off–balance transactions have been actively used by private–sector financial institutions. If calculation of the public financial sector's share includes the figures of off–balance transactions, the share of the public sector would be significantly smaller than that of this article.

2) In fact, the Government Housing Loan Corporation has shifted its focus from direct financing to credit enhancement service.

3) This article does not consider the Postal Life Insurance business. According to the estimation by the Life Insurance Association (2002), the amount of tax exemption for the Postal Insurance Service (accumulated amount over 10 years, from FY1991 to 2000) is as follows: business taxes– JPY1,198.7 billion, corporate and resident taxes– JPY1,949.6 billion and JPY 3,148.3 billion in total. Furthermore, the Association notes that it did not pay the contribution to the Policyholders Protection Corporation (for FY1998 to FY2000) worth JPY33.6 billion.
asset taxes, and stamp duties)—JPY 130.6 billion, deposit insurance premiums—JPY 209.9 billion, interest from investments in the amount equivalent to the reserve deposits—JPY 38.7 billion, and corporation and resident taxes—JPY 233.2 billion. The amount accumulated over the last 10 years is JPY 4,646.3 billion (see Table 4). In this Section, the Japanese Bankers Association’s estimation of the “privileges for government enterprises” is examined.

Table 4    Privileges of the Postal Savings as Government Enterprise (hundred millions yen)

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</tr>
</thead>
<tbody>
<tr>
<td>Taxes as ordinary expenses</td>
<td>1,461</td>
<td>1,269</td>
<td>1,425</td>
<td>1,863</td>
<td>1,219</td>
<td>1,701</td>
<td>1,337</td>
<td>1,285</td>
<td>1,096</td>
<td>1,306</td>
</tr>
<tr>
<td>Deposit insurance premiums</td>
<td>187</td>
<td>204</td>
<td>220</td>
<td>1,660</td>
<td>1,793</td>
<td>1,889</td>
<td>2,021</td>
<td>2,122</td>
<td>2,184</td>
<td>2,099</td>
</tr>
<tr>
<td>Interest from investment in the amount equal to deposit</td>
<td>1,024</td>
<td>920</td>
<td>1,029</td>
<td>847</td>
<td>847</td>
<td>698</td>
<td>514</td>
<td>607</td>
<td>605</td>
<td>387</td>
</tr>
<tr>
<td>Corporate and resident taxes</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>3,021</td>
<td>4,540</td>
<td>750</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>2,332</td>
</tr>
<tr>
<td>Government enterprise privileges (Total)</td>
<td>2,671</td>
<td>2,393</td>
<td>2,675</td>
<td>7,391</td>
<td>8,399</td>
<td>5,039</td>
<td>4,014</td>
<td>3,872</td>
<td>3,885</td>
<td>6,125</td>
</tr>
<tr>
<td>Accumulated amount of the privileges</td>
<td>5,065</td>
<td>7,739</td>
<td>15,130</td>
<td>23,530</td>
<td>28,568</td>
<td>32,440</td>
<td>36,454</td>
<td>40,339</td>
<td>46,463</td>
<td></td>
</tr>
<tr>
<td>Outstanding postal savings (JPY in trillions)</td>
<td>170</td>
<td>184</td>
<td>198</td>
<td>213</td>
<td>225</td>
<td>241</td>
<td>253</td>
<td>260</td>
<td>250</td>
<td>239</td>
</tr>
<tr>
<td>Interest advantages (%)</td>
<td>0.16</td>
<td>0.13</td>
<td>0.14</td>
<td>0.35</td>
<td>0.37</td>
<td>0.21</td>
<td>0.15</td>
<td>0.15</td>
<td>0.16</td>
<td>0.26</td>
</tr>
</tbody>
</table>

Source: the Japanese Bankers Association (2002); outstanding postal savings is quoted from material disclosed by the Postal Savings. Interest advantages (=government enterprise privileges/outstanding postal savings) are calculated by the authors.

III. 2.  Interest from the Amount Equal to Deposit Reserves

First, the interest from the amount equal to deposit reserves was examined. To do so, we need to examine an estimate of the amount of deposit reserves required if the Postal Savings joined the deposit reserve requirement system, and then at what interest rate the Postal Savings could have invested the funds.

The average effective reserve requirement ratio for private banks’ deposits (excluding foreign currency and nonresident yen deposits) was 0.64% in March 2002. By applying this percentage, as the outstanding postal savings stands at JPY 239 trillion, the amount required for deposit reserves is calculated as JPY 1.53 trillion. Since the coupon for a 10–year government bond upon issuance is 1.4% (March 2002), using this interest rate, the amount of interest from investments is JPY 21.4 billion.

On the other hand, if the deposit reserve requirement ratio for banks is strictly applied, because the current deposit reserve requirement ratio is progressive, the applicable ratio would be
very close to the maximum reserve ratio for the enormously large Postal Savings. Accordingly, the reserve requirement (for FY2001) is calculated as JPY 2.89 trillion. In this case (assuming an interest rate of 1.4%), the interest from an amount equal to the reserve deposits is calculated as JPY40.5 billion. Figures as of the end of March 2002 were used for this calculation, but a similar result was estimated by JBA.

However, it is believed that calculation of interest based on the long-term government bond rate leads to overestimation. Although the rate of the 10-year government bond was, as described earlier, approximately 1.4%, whether it is appropriate to apply long-term interest rates as the opportunity cost for deposit reserves is questionable. Actually, when a shortage of funds in the deposit reserve account is feared, banks do not take long-term borrowings but usually take advantage of short-term funds in the call market. At such time, the interest rates in the call market should be used as the opportunity cost for deposit reserves. In this case, as a result of a so called zero interest rate policy, even if the overnight unsecured call rate is applied, the maximum opportunity cost would be JPY 350 million. Therefore, even if deposit reserves were required at the same level as private banks, assuming a zero interest rate, it is more logical to consider the burden of the Postal Savings increasing only by approximately several hundred million yen. Therefore, it is clearly an overestimation that the Postal Savings has privileges worth JPY 38.7 billion as the amount “equal to the interest from investment”.

In addition, with the establishment of the Japan Post on April 1, 2003, the Japan Post is now required to retain a current deposit account at the Bank of Japan that corresponds to the reserve deposit account for private-sector financial institutions, and the contribution rate was determined by the Bank of Japan. In practice, the average effective reserve ratio over the last year of the private-sector financial institutions is applied.

In consideration of the above, there would be hardly any advantage for the Postal Savings in terms of deposit reserves under the zero interest rate policy. Moreover, after incorporation, since required funds must be deposited in an account at the Bank of Japan under similar rule as that of private corporations, the advantages from the deposit reserve would be negligible (although the difference in calculation of the reserve ratio remains).

**III. 3. Deposit Insurance Premium**

Next, the deposit insurance premium burden was examined. First, the deposit insurance rate, 0.084% (FY2001), is multiplied by the year-end outstanding postal savings, resulting in JPY 201.6 billion, which is almost equal to the estimation by JBA. Since the deposit insurance premium increased significantly to 0.084% in FY1996 from a previous 0.012%, the effect of the deposit insurance premium exemption became significant.

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6) Overnight unsecured and secured call rates were 0.012% and 0.001%, respectively (March 2002).
However, the size of the privileges from the deposit insurance should be kept in perspective. In other words, private-sector financial institutions as a whole, receive funds from the deposit insurance scheme on a net basis. By the end of FY2002, since deposit insurance premiums could not cover the cost of the disposal of failed financial institutions, JPY10,743 billion was contributed (the realization of delivery bonds) from government funds. It is natural for solid financial institutions that are well-managed without deposit insurance, to be discontent with the system as it appears to only impose a burden. However, as seen from the perspective of private-sector financial institutions as a whole, the deposit insurance is not a burden, but is beneficial. And, if deposit insurance premiums are set up fairly, for most member financial institutions, the amount of insurance premiums paid and received will be equal, so it can be considered that basically no cost is incurred.7)

Of course, from the standpoint of periodic income of a single financial institution, there is no doubt that a deposit insurance premium is a cost for an improved safety level for deposits. In this regard, as postal savings are guaranteed by the government without charge, Postal Savings are clearly treated favorably. It is also realized that current insurance rates are unduly high for healthy financial institutions which can procure deposits even without the deposit insurance scheme, resulting in a disadvantaged competitive position with the Japan Post. From this viewpoint, requiring the Japan Post to join the deposit insurance scheme is a way to equalize competitive conditions.

However, from the standpoint of private banks, stating that the Postal Savings should join the deposit insurance scheme is not so simple. Since the deposit limit of the Postal Savings is JPY 10 million, if the Postal Savings fails, such losses by the Postal Savings must be fully assumed by the Deposit Insurance Corporation. Given the cases of failed banks in the past, if the Postal Savings with savings of JPY 230 trillion (March 2003) fails, the amount the Deposit Insurance Corporation must assume is expected to be an amount in the order of several trillion yen.8) Under the current Deposit Insurance Law, disposal must be covered by deposit insurance premiums in principle. But, if the Postal Savings fails, it does not seem to be possible for other member financial institutions to cover the loss. So, if private institutions demand that the Postal Savings join the deposit insurance scheme, but will request the government to cover any loss that may occur in a crunch, participation in the deposit insurance scheme by the Postal Savings would actually mean that private banks ask being supported by the Postal Savings.

It seems more realistic that solid private-sector financial institutions should seek the adoption of the risk-based deposit insurance rates in order to restore a competitive advantage over the

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7) Regarding the periods when payoff is frozen, from a depositor’s viewpoint, deposit in the Post Office is protected up to JPY10 million (due to the deposit limit) while the deposit in private-sector financial institutions are covered without a ceiling. Therefore, private-sector institutions are favored with regards to limits in protection.

8) For example, in case of Hokkaido Takushoku Bank’s failure, the amount contributed from the Deposit Insurance Corporation was JPY 1,794.7 billion. As of the end March 1997, Hokkaido Takushoku Bank had deposits of JPY 6,780.7 billion. So, a pecuniary gift worth 26% of deposits was made.
Postal Savings. In fact, in the United States, deposit insurance premium rates are zero for the well qualified banks.

Lastly, it should be pointed out that giant organizations such as the Postal Savings are “too big to fail” in the first place. Therefore, it is not realistic to consider deposit insurance as a safety net in case the Postal Savings fails. It is important to require conservative asset management to avoid failure. Current fund management of the Postal Savings has more restrictions than private institutions. Observing these restrictions can be considered as opportunity costs paid in place of a deposit insurance premium payment. Deregulation of restrictions on the Postal Savings’ fund management should be carefully considered.

III. 4. Burden of Tax

The Japanese Bankers Association estimates that, in terms of corporate and resident taxes, privileges given to postal savings amount to JPY 233.2 billion (FY2001). This estimate is made on the assumption that taxes are imposed on the profits of the Postal Savings. One problem is that the profits posted by the Postal Savings differ from the profits on the private corporations’ standards. For instance, since retirement allowance liabilities were not realized before the incorporation of the Japan Post, expenses were undervalued and profits were overvalued by that amount.

To begin with, as the post service operated on the principle of a balanced budget of income and expenditure, unlike private companies, it did not aim to make a profit and thus did not need to pay corporate and resident taxes imposed on its profits. In consideration of these facts, even if a corporate tax was imposed at the same rate as private banks’, there would be almost no tax payment. That is, there is no “government enterprise privilege” in terms of corporate and resident taxes. And, though it is rather irregular, in order to support disposal of now-defunct Japanese National Railways’ long-term debts, from FY1998 to FY2002, JPY 200 billion (JYP1 trillion in total) was exceptionally transferred from a special postal savings account to the general account each year, which can be regarded that a special tax was imposed on Postal Savings. According to JBA’s estimation, the amount of corporate and business tax exemption for the last 10 years would be JPY 1,064.3 billion; however, the special “tax payment” are almost equal to this estimated amount.

In addition, the Japan Post is required to make payment (when the 4-year medium-term plan is completed) if the amount of revenue reserves exceeds the base amount (= JPY 150 billion + outstanding savings × 3% − the Japan Post’s capital fund), and 50% of the amount exceeding the base amount is to be paid to the State. As the Japan Post’s equity capital is small, payment is not expected for some time to come, but once the amount of reserve reaches that base amount, it is possible to say that the tax rate may be higher than that of private-sector financial institutions. Therefore, it can be concluded that as a result of the incorporation of the Japan Post, any “government enterprise privilege” has been completely evaporated in terms of corporate and
residual taxes.

Furthermore, unlike a corporate tax that is imposed on profits, "taxes as ordinary expenses" (e.g., fixed asset taxes, stamp duties, etc) must be paid even if the organization does not operate at a profit. According to JBA’s estimation, the amount of exemption is JPY 100 billion every year. Exemption of “taxes as ordinary expenses” obviously gives an advantage to the Postal Savings and can be recognized as a “government enterprise privilege”. Unfortunately, the authors cannot verify the accuracy of the amount calculated. 9)

In addition, the Japan Post starts to pay a profit margin (effectively 50% of the fixed asset tax) to municipalities where the Japan Post has major fixed assets, such as post office buildings. Therefore, exemptions of “taxes as ordinary expenses” are expected to be lower after the incorporation of the Japan Post.

III. 5. Where Did Government Enterprise Privileges Disappear to?

If, according to the Japanese Bankers Association estimation, JPY 4.6 trillion was given over 10 years to the Postal Savings as government enterprise privileges (which is overestimated in the authors’ opinion), where did such privileges go? Given the fact that the Postal Savings has no shareholders and no investment or loan activities, it could not have been returned to the shareholders or borrower companies. So, the privileges must have disappeared due to: 1) expenses are relatively high; 2) business expanded beyond the optimal level; or 3) they were reflected on the savings’ interest rates.

First, if the Post Office's expenses are relatively high, though this would cause problems for the national economy, it could not squeeze the private-sector financial institutions. In fact, the expense ratio of the banks is higher than that of the Postal Savings.

How about the interest rates for deposits and savings? As the outstanding postal savings is JPY 239 trillion (March 2002), if “government enterprise privileges” for FY2001 is returned to depositors in the form of the interest rate, it would be 0.26%. Of course, as the interest rates are excessively low in recent years, this difference in interest rates may not be marginal. For example, in December 2003, the deposit interest rate of fixed-term deposits (with the principal of JPY 3 million or less) was 0.033% on national average. Adding 0.26% would make a significant difference. However, the actual interest rate for Post Office’s time savings is 0.03% and at the same level as that at major banks. Therefore, the Post Office does not place private banks under pressure by taking advantage of “government enterprise privileges” in terms of the interest rate.

Accordingly, if there is any government enterprise privilege, it must have been spent on the expansion of the Postal Savings. For FY2001, the postal savings business’ personnel and

9) For example, favorable stamp duties are imposed on credit associations and JAs. Whether the burden of stamp duties imposed on the Postal Savings should be equal to that of banks requires further consideration.
non-personnel costs were JPY 651.1 billion and JPY 441 billion in total, respectively.\textsuperscript{10}) In other words, the average government enterprise privileges per year (JPY 465 billion) represented 42.6\% of the operating expenses. Therefore, if the Postal Savings lost "government enterprise privileges", the size of the business must be reduced significantly.

There are 538 municipalities where there are no private-sector financial institutions (banks and credit associations) and 696 municipalities with only one private-sector financial institution in 2003. Private-sector financial institutions do not operate offices in these locations because no profit can be expected, but even in these areas, there is at least one post office. The fact that income and expenditure are balanced, even with government enterprise privileges, suggest that part of the government enterprise privileges is spent to cover the operating costs of offices in "loss-making" areas. Calculating the size of “government enterprise restrictions”, such as the operation of offices in "loss-making" areas, in comparison with "government enterprise privileges" is another important issue.

III.6. Summary

It has been concluded that the estimation by JBA that "government enterprise privileges" given to the Postal Savings amount to JPY 4.6 trillion over 10 years is an overestimation, and that it is difficult to believe that government enterprise privileges given to the Post Office pose disadvantages to private-sector financial institutions. Furthermore, many of these privileges have been eliminated as a result of institutional reforms. Therefore, if government enterprise privileges had once given advantages to the Post Office, the reversal should occur in the near future.

However, the fact that the postal savings business has a kind of government enterprise privileges is not debated. Actually, exemption of “taxes as ordinary expenses” obviously gives the Post Office an advantage. But since "government enterprise restrictions" are simultaneously imposed, "government enterprise privileges" must be considered on a net basis instead of gross. Unfortunately, the size of such privileges and restrictions has yet to be accurately measured. Only after this has been done, we can choose the best method in order to achieve policy objectives.

IV. Conclusion

In this article, we discussed the public financial sector which plays an important role in Japanese financial system from two aspects. First, we discussed whether the Japanese public financial sector has ballooned on a global basis. This ballooning theory is the premise for arguments regarding public financial system reforms, and as this article suggested, the public sector’s share varies widely depending on the definition of the range of public financial activities.

\textsuperscript{10}) Postal Savings, Statement of the Special Account for Consolidated Public Services Incurred
For example, if credit enhancement by the government is deemed as a part of financial activities, public financial system would have greater weight in the United States than in Japan. In addition, it was proven that the ratio of government–related and non–government–related assets to personal risk–free assets is almost the same in Japan as that in the United States. Therefore, we can conclude that the ratio of government–related assets (including postal savings) to personal financial assets is higher in Japan than in the United States because the Japanese households have demonstrated a greater tendency toward risk–free assets than U.S. households.

Secondly, this article examined whether Japanese private–sector financial institutions are at a disadvantage to the Post Office due to the existence of “government enterprise privileges.” It is true that government enterprise privileges are given to the Postal Service, but the estimation made by a private–sector institution was excessive, and a number of privileges have been lost through institutional reforms. On the other hand, a number of government enterprise restrictions (for example, maintaining offices in loss–making areas where private banks do not operate) are still imposed. If government enterprise privileges are lost, satisfying government enterprise restrictions will become impossible. Discussions should be held in preparation for these situations.
References
